

February 4, 2004

**Barbara A.
Schmerhorn
Clerk**

NOT FOR PUBLICATION
**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

IN RE JON STERLING WOMACK and
CYNTHIA ANN WOMACK,

Debtors.

BAP No. KS-03-041

VERLIN A. INGRAM and ROBERT
BROWN,

Bankr. No. 97-42738-7
Adv. No. 02-7165
Chapter 7

Plaintiffs – Appellees,

v.

ORDER AND JUDGMENT*

JON STERLING WOMACK,

Defendant – Appellant.

Appeal from the United States Bankruptcy Court
for the District of Kansas

Before BOHANON, CORNISH, and STARZYNSKI¹, Bankruptcy Judges.

CORNISH, Bankruptcy Judge.

We are asked to review the bankruptcy court's determination under 11 U.S.C. § 523(a)(4) that the Debtor had a fiduciary duty to maintain funds in his trust account specified by a state court restraining order, and that Debtor's failure to maintain the funds was a defalcation while acting in a fiduciary capacity. For the reasons set forth below, we AFFIRM.

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

¹ Honorable James S. Starzynski, United States Bankruptcy Judge, United States Bankruptcy Court for the District of New Mexico, sitting by designation.

BACKGROUND

On October 6, 1997, Debtor and his wife filed for relief under Chapter 13 of the Bankruptcy Code. Verlin A. Ingram (“Ingram”) filed a proof of claim, believing Debtor owed him money as a result of a law partnership between them. Ingram obtained stay relief and filed an action in Kansas state court for dissolution of the partnership. In May 1999, the state court entered a restraining order that required Debtor and Ingram to retain any attorney fees and expense reimbursement they might receive in their respective trust accounts, pending further order of the court.

Later, Debtor and Ingram reached a tentative settlement, but were unable to agree on a final journal entry that would resolve the dissolution proceeding. The state court nevertheless entered a judgment on July 13, 2001, concluding that the parties were bound by the settlement, and that Debtor owed Ingram \$40,224.84 under the settlement agreement. The court also found that Debtor had violated the restraining order by disposing of the fees that were to be held in trust, and awarded \$11,500.00 in attorney fees and \$623.10 in expenses in favor of Ingram.

The Debtors converted to Chapter 7 in September of 2002, listing Ingram as an unsecured creditor owed \$40,225.00, and Ingram’s attorney, Robert Brown (“Brown”) as an unsecured creditor owed \$11,150.00. Ingram and Brown joined in a dischargeability complaint, arguing that the state court judgment is covered by 11 U.S.C. § 523(a)(4) and (6). The bankruptcy court first found that the state court’s restraining order required the Debtor to hold contested fees in a fiduciary capacity. The bankruptcy court then determined that Debtor’s removal of money from his trust account in violation of the restraining order constituted a defalcation under 11 U.S.C. § 523(a)(4). The bankruptcy court did not make a determination regarding Ingram and Brown’s assertions under § 523(a)(6). This appeal timely followed.

APPELLATE JURISDICTION

The Bankruptcy Appellate Panel has jurisdiction over this appeal. An order

finding a debt nondischargeable is a final order. Appellant timely filed his notice of appeal pursuant to Rule 8002, Fed. R. Bankr. P., and the parties have consented to this court's jurisdiction by failing to elect to have the appeal heard by the United States District Court for the District of Kansas. Fed. R. Bankr. P. 8001-02; 28 U.S.C. § 158(c)(1).

STANDARD OF REVIEW

“For purposes of standard of review, decisions by judges are traditionally divided into three categories, denominated questions of law (reviewable de novo), questions of fact (reviewable for clear error), and matters of discretion (reviewable for ‘abuse of discretion’).” *Pierce v. Underwood*, 487 U.S. 552, 558 (1988); *see* Fed. R. Bankr. P. 8013.

We review the bankruptcy court's legal determination de novo and its factual findings for clear error. *See Osborn v. Durant Bank & Trust Co. (In re Osborn)*, 24 F.3d 1199, 1203 (10th Cir. 1994). The determination of the nondischargeability of debt is an issue of law that we review de novo. *United States v. Victor*, 121 F.3d 1383, 1386 (10th Cir. 1997).

DISCUSSION

Debtor argues that the debt in question arose out of a breach of contract rather than a breach of fiduciary duty. Based on this, Debtor advances that the requirements set out in § 523(a)(4) are not met. Debtor further contends that there was no fiduciary relationship between the parties, stating that the state court restraining order never created a trust.

Section 523(a)(4) provides that a Chapter 7 debtor is not discharged from any debt resulting from “fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” 11 U.S.C. § 523(a)(4). Two elements are required: (1) a fiduciary relationship; and (2) defalcation committed during the course of that relationship. *Fowler Bros. v. Young (In re Young)*, 91 F.3d 1367, 1371 (10th Cir.

1996); *Klenda v. Hogue (In re Hogue)*, 221 B.R. 786, 793 (Bankr. N.D. Okla. 1998). Federal law dictates whether a fiduciary duty exists under § 523(a)(4); however, state law is important in making the determination. *Young*, 91 F.3d at 1371. “[T]o find that a fiduciary relationship existed under § 523(a)(4), the court must find that the money or property on which the debt at issue was based was entrusted to the debtor. Thus, an express or technical trust must be present for a fiduciary relationship to exist under § 523(a)(4).” *Id.* (citation omitted). A general fiduciary duty is insufficient to establish a fiduciary relationship under § 523(a)(4). *Id.* at 1372.

Once a fiduciary duty is established, there must be a finding of defalcation. “Defalcation” under § 523(a)(4) has been broadly construed by this Court. Defalcation includes any failure to account for funds that have been entrusted to the fiduciary. *Antlers Roof-Truss & Builders Supply v. Storie (In re Storie)*, 216 B.R. 283, 288 (10th Cir. BAP 1997). Defalcation does not require fraudulent or negligent intent. *Id.* at 286-88; *Merrill v. Merrill (In re Merrill)*, 252 B.R. 497, 505-06 (10th Cir. BAP 2000), *aff’d without published opinion*, 15 Fed. Appx. 766 (10th Cir. 2001).

The bankruptcy court found that the state court’s restraining order required Debtor to hold contested fees in a fiduciary capacity. The court noted that the order identified certain client matters and directed Debtor to hold any fees received in connection with those matters, pending further order of the court. The trial judge gave great weight to the fact that not only did Debtor fail to honor the state court restraining order, but that as an attorney, he was also an officer of the court. We agree.

Debtor offered several justifications to the bankruptcy court for his failure to hold the fees in his trust account pursuant to the restraining order. The first was that the Debtor believed his duty was to the bankruptcy trustee and that all money that could be identified to him alone should be used to preserve the bankruptcy estate. The second justification was the Debtor believed that any motion filed regarding the state court’s

permission to remove money from the trust account would be an acceptance of the state court's jurisdiction over the money, which the Debtor denied existed. The third justification offered by the Debtor was that filing a motion would have been a useless act because he always had the right to convert to a Chapter 7 case and all collection efforts would have had to cease upon conversion. The bankruptcy court fully discussed each of the Debtor's contentions, and did not accept any of the assertions. The bankruptcy court concluded that since the restraining order required the Debtor to hold the money in his trust account, and he removed some of the money without approval of the court, the Debtor committed defalcation under § 523(a)(4).

This Court has reviewed the arguments of the Debtor, the bankruptcy court's order, and evidence presented. The bankruptcy court's conclusions of law are not erroneous. The bankruptcy court's decision contains a thorough discussion of the issues in this case.

CONCLUSION

For the reasons set forth above, the "Order Determining Obligation Will be Nondischargeable Unless Materially Altered through the State Court Appeal and any Subsequent Proceeding" is AFFIRMED.